Speech by SEC Staff: Corporation Finance in 2008 — A Focus on Financial Reporting

by

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35th Annual Securities Regulation Institute
San Diego, California
January 23, 2008

Good morning. Thank you David [Van Zandt]. I'm very pleased to welcome all of you to the 35th Annual Securities Regulation Institute. It is my privilege and honor to be chairing the program for the first time this year, and I thank each of you for being here. I believe we've put together a great series of panels for you over the next few days and I'd like to take this opportunity to thank everyone who has worked so hard to make this all happen. Our highlight will be at lunch today, when former Chairman of the SEC, David Ruder, who has been so closely associated with the Institute for many years, will give the Alan B. Levenson Keynote Address and offer his insights in a speech entitled "Challenges Facing the SEC in the Year 2008 and Beyond."

Wanting to get a jump on David's remarks, I will first mention a quote of Alan Levenson, one of my predecessors as Director of the Division of Corporation Finance, that we repeat year-after-year at this conference. In founding this conference 35 years ago in order to further the staff's outreach to the private bar, Alan explained:

> I felt that the private bar was essential to effective operations of the SEC, and the more that we could share information and do away with the mystery, it would result in the protection of investors, both from a disclosure standpoint and in the raising of capital for our capital markets, which is so crucial.

I have tried during my time as Director to reinforce Alan's theme, by making a promise of transparency in Corporation Finance, which includes both speaking publicly about our plans and making sure that remarks at conferences like this are posted on our website to share with all who interact

with the Division. As I said a year ago when laying out the Division's agenda for 2007, transparency is an important principle for regulators, as well as for the disclosure that we ask companies to provide in response to our regulations. So let me see if I can put that into action this morning.

When I laid out the Division's 2007 agenda early last year,[1] there were 11 items listed — by the time of my update in August, it had grown to 14.[2] We had a quite active year in following that agenda, producing a fair amount for us to discuss in the next few days. By my count, Corporation Finance recommended to the Commission in 2007, and the Commission approved, 27 rulemaking releases — final rules, proposed rules and even three concept releases and an interpretive release. Today, however, instead of giving you another numbered list of projects, I thought I would look at our activities a bit differently — somewhat more by theme. But I do intend to honor my promise of transparency and, as best I can, give you a review of where we have been in the last year and a preview of where we are headed in Corporation Finance in 2008. At lunch, David Ruder will offer some more global thoughts on the SEC's path for 2008 and beyond. Of course, before I get into the substance of my remarks, I'll start with my standard disclaimer — the views I express today are my own, and do not represent the views of the Commission or any other member of the staff. This is particularly important to remember as I discuss possible future areas of rulemaking.

Last year, we had several themes that drove our agenda:

- executive compensation disclosure, including roll-out of our new rules adopted in 2006,
- management guidance and the PCAOB's new Auditing Standard No. 5, responding to concerns about the efficiency and effectiveness of implementation of Sarbanes-Oxley Section 404,
- smaller public company and private offering rulemaking, including responding to the 2006 report of the Advisory Committee on Smaller Public Companies,
- proxy matters, including responding to changes in technology and to a 2006 court decision, and
- international matters, including deregistration and International Financial Reporting Standards, and responding to our increasingly global markets.

So, I will include in today's report an update as to where we are on each of these, and discuss what remains to be done this year. But primarily I want to focus on the two themes that are driving our activities this year, particularly possible rulemaking plans. The biggest area of focus for us in 2008 is financial reporting, including reviewing the Commission's new Advisory Committee on Improvements to Financial Reporting (CIFiR), which is actually planning to vote on a number of recommendations to be included in a

progress report in a few weeks. Within financial reporting (very broadly defined), I am including use of interactive data, IFRS for U.S. issuers, various proposed recommendations of the CIFiR (including on materiality and restatements and use of websites for disseminating financial information), SOX 404 and even oil and gas disclosures. The other leading area of focus for this year in Corporation Finance is international matters, which I discussed at some length last week in London, in remarks titled "Corporation Finance in 2008 — International Initiatives." I will touch on these international themes only in summary form today, and will point you to the full text of my companion remarks last week on our website.[3]

With that, let me get started.

Financial Reporting

A focus on financial reporting and steps to improve, on an effective and efficient basis, the comparability, accessibility and reliability of financial information is a hallmark of our current efforts in Corporation Finance. So I would like to discuss this morning how these themes are manifested in our plans for 2008.

Interactive Data. Interactive data continues to be a key priority for Chairman Cox and for the rest of us at the Commission, with substantial progress being made in 2007 and much more in store for 2008. By interactive data I am referring to a company's ability to use a computer software language to tag its financial data with codes from standard lists, called "taxonomies," so that investors and other users can more easily locate and analyze desired information. XBRL, or eXtensible Business Reporting Language is the primary software language that the Commission is focused on.

Probably the biggest XBRL accomplishment in 2007 was completion in September of the development of XBRL data tags mapping the entire system of U.S. GAAP.[4] These comprehensive U.S. GAAP taxonomies stretch across all industry and business sectors to tag complete sets of financial statements, including footnotes. The taxonomies, together with a users' guide, were released by XBRL U.S. for public testing and comment in December, with the comment period ending in early April this year.[5]

Other milestones in 2007 included formation in October of a new Office of Interactive Disclosure within the Commission,[6] expansion of our group of companies that have agreed to voluntarily tag their disclosure to more than 40 companies having a combined market capitalization of over $2 trillion,[7] and release of the second prototype of an Interactive Financial Report Viewer that enables investors to analyze companies' interactive data filings.[8] The voluntary program remains open and companies are urged to join. If there is any doubt in your mind where and how rapidly the use of interactive data is moving, I direct you to a November 9 press release on the Commission's website summarizing Chairman Cox's discussions in Tokyo with securities regulators around the world and the progress in other countries in implementing interactive data.[9]

How does all this relate to our agenda in Corporation Finance? As I have said before, we are ready in the Division to undertake further rulemaking whenever the technology is ready. That time is fast approaching. In September, the Chairman asked for a staff recommendation this spring (which could be a rulemaking proposal), with possible final action coming this fall. This would be an aggressive schedule but, importantly, there's time in that schedule for a real field test of the taxonomies released for comment in December by our voluntary filers in their 2008 quarterly filings. If successful, you can guess where this is all likely to lead.

Adding to this, the CIFiR plans to vote next month on a developed proposal that the SEC mandate the submission of XBRL-tagged financial statements. This step would be conditioned on successful taxonomy testing, the capacity of reporting companies to file XBRL-tagged financial statements using the new U.S. GAAP taxonomy on the SEC's EDGAR system, and the EDGAR system providing an accurate rendered version of all such tagged information. Under the Committee's draft developed proposal, use of XBRL-tagged financial statements would be phased in, starting with the largest 500 domestic public reporting companies furnishing a separate XBRL-tagged document, then adding in other domestic large accelerated filers. After this initial phase-in and the satisfaction of the above conditions, the Committee's draft developed proposal calls for the Commission to then consider whether and when to move from furnishing to filing of the XBRL-tagged financial statements for large accelerated filers, and the addition of other reporting companies. In doing so the Committee believes that the Commission should be sensitive to the needs of smaller public companies and the need for proven and inexpensive software for them to use.

Now I can't tell you how fast all this will develop and what we will recommend, but with the Chairman's prior request to the staff, in combination with the Committee's recommendations, there is a lot going on here. So this is a good one to start thinking about if you haven't already.

Finally, as a demonstration of the use of data-tagging, this past December the Commission introduced on its website an "Executive Compensation Reader."[10] The reader enables investors, for the first time, to easily and instantly compare executive compensation disclosure of 500 large companies that have filed proxy statements using our new executive compensation disclosure rules. This is a useful tool for all to see how XBRL works in action, and it illustrates how user-friendly XBRL can be. The executive compensation data can be filtered and organized to give you the exact comparative data you want. So, if you want to compare, for example, the executive compensation data for all CFOs in the financial institutions industry, you can get it in two clicks. Go to our website and give it a try.

Advisory Committee on Improvements to Financial Reporting (CIFiR). As you are probably aware, last summer the Commission formed the Advisory Committee on Improvements to Financial Reporting to study the causes of financial reporting complexity and recommend to the Commission how to

make financial reports clearer and more beneficial to investors, reduce the costs and unnecessary burden for preparers, and better utilize advances in technology to enhance all aspects of financial reporting.[11] Specific topics of study include how to approach setting financial accounting and reporting standards, how the process of regulating compliance by registrants and financial professionals with accounting and reporting standards can be improved (and this even includes a look at the Corporation Finance review process), and a focus on the systems for delivering financial information to investors and accessing that information.

The Committee has been remarkably active in its first six months, and though its report and recommendations are not due until next August, the Committee is scheduled to vote on interim proposals (called developed proposals) on February 11. The Committee held its most recent meeting on January 11, at which they released a Draft Decision Memo previewing what are likely to be their developed proposals. A copy of this memo is available on the SEC's website.[12] The staff is very interested in the Committee's work and we are looking at how best to react to the developed proposals when they are issued.

Some of the Committee's most interesting draft developed proposals relate to materiality and the correction and disclosure of accounting errors. As to materiality, the Committee stressed the distinction between materiality on the one hand, and the need to restate on the other hand. In the Committee's view, whether a material accounting error should lead to a financial restatement depends on the viewpoint of current investors. I agree that this is an important distinction. For example, there could be an error made six years ago that is material — but does not necessarily result in the need for a restatement. The passage of time does not make a material error immaterial — but it might impact what corrective action should take place.

The Committee discusses in the Draft Decision Memo a possible developed proposal that the Commission or the staff issue guidance reinforcing that those who evaluate the materiality of an accounting error should make the decision based on the perspective of a reasonable investor. In the Committee's view, materiality should be judged based on how an error impacts the total mix of information available to a reasonable investor, and the evaluation of errors should be made on a "sliding scale," recognizing that qualitative factors can lead to a determination that a quantitatively significant error may not be material (just as qualitative factors can be used to lead to a conclusion that a quantitatively small error is material).

The Committee also discussed in the Draft Decision Memo a possible developed proposal whereby the Commission or the staff would issue guidance on how to correct an error consistent with specified principles, including the principle that prior period financial statements should only be restated for errors that are material to those prior periods. This might involve a revision of certain provisions of Staff Accounting Bulletin 108,[13] which today could be interpreted as causing a restatement if a correcting entry is material to the current period - even though prior periods are not changed

materially as a result of the restatement. In this regard, the Committee discusses in the Draft Decision Memo an alternative to the approach in Staff Accounting Bulletin 108 under which errors that are not material to the prior annual periods in which they occurred, but would be material if corrected in the current annual period, could be corrected in the current annual period with appropriate disclosure.

Along these same lines, the Committee discussed a possible developed proposal that the Commission or the staff issue guidance, subject to specified principles, on applying materiality to errors identified in prior interim periods and how to correct those errors.

All of this is a focus for the staff. As many of you have read, or perhaps personally experienced, there have been a number of restatements in recent years to correct errors in financial statements. The determination if an error is material requires the professional judgment on the part of the preparer — frequently with the advice of its legal counsel — and the auditor. There have been situations in which a company has taken a view that an error is not material but the staff was unable to concur with that position. While these situations are not common, we have become aware of other situations in which a company is advised by its accounting and legal experts that it should restate based on the expectations of the staff's conclusion regarding materiality, without actually engaging with the staff. Please do not presume the staff's conclusion regarding materiality and the need to restate financial statements. Rather, I encourage a discussion with the staff. I have asked Wayne Carnall, our new Chief Accountant in the Division, to particularly focus on this process.

So, as you can probably imagine, we currently are looking closely at the topics of materiality and restatements and evaluating the Advisory Committee's draft developed proposals in this area.

On another topic, the Committee also discussed a draft developed proposal encouraging the Commission to consider various actions with respect to establishing a professional judgment framework and encouraging the PCAOB to consider similar action. Other draft developed proposals relate to XBRL, which I outlined a moment ago, and corporate websites, which I will get to shortly when I discuss our efforts in that area. Of course, I don't have time today to discuss all of the issues considered by the Committee to date.

So, in closing on this topic, I'd definitely recommend taking a look at the Committee's Draft Decision Memo and watching this process closely in the coming months.

Restatements and Item 4.02 of Form 8-K. I've discussed the topic of restatements and Item 4.02 of Form 8-K on a few different occasions over the past year, and this continues to be a focus for us. The issue here is "stealth restatements" — issuers placing disclosure of a decision that its past financial statements should no longer be relied on in a periodic report rather than a separate 8-K filing. As you may know, the staff has an FAQ directly on

point, which we had thought made clear that we believe that the disclosure is required in a separate Form 8-K filing.[14] However, as you may recall, the General Accounting Office has asked us to look into the practice further. I think it is likely that you will see rulemaking to address the issue this year, and you can infer from our FAQ what direction it likely would go, but I can't tell you much more than that at this point.

Corporate Websites. As I mentioned when I was going through the Advisory Committee's expected recommendations, the staff has been looking at whether and, if so, how we should update the interpretive guidance that the Commission issued in 2000 concerning the use of corporate websites for disclosures of information.[15] Consider how investors receive financial data today as compared to seven years ago — blast emails, webcasts of meetings, blogs, RSS feeds, electronic shareholder forums, podcasts, XBRL, electronic proxy solicitation. Consider also how technology can make it easier and more efficient for investors to find the financial data and analysis they are looking for. Legal issues that may need to be addressed or updated include treatment of hyperlinked information on a company's website, liability for disclosures, Regulation FD, and public availability of information. The Committee's draft recommendation that we look at these issues and issue new interpretive guidance to encourage further creative use of corporate websites and to promote industry best practices is timely in this regard, and we are certainly very interested in their thoughts. I wouldn't hazard a guess on timing of any new interpretive guidance here, but I can tell you it is something we've been thinking about pretty seriously for some time now.

Oil and Gas Disclosure. On to another disclosure area where you may be seeing some changes — after hinting for over six months now that we wanted to look at our disclosure rules concerning oil and gas reserves, last month the Commission issued a concept release seeking comment on the extent and nature of the public's interest in revising the oil and gas reserves disclosure requirements in Regulation S-K and Regulation S-X.[16] These disclosure requirements were originally adopted between 1978 and 1982 and in the time since then significant changes in the oil and gas industry have led many to believe that our disclosure requirements need updating. In particular, some commentators have expressed concern that the Commission's disclosure requirements have not adapted to current practices and may not provide investors with the most useful picture of oil and gas reserves held by public companies.

This is an area we've wanted to address — we even brought on an Academic Engineering Fellow, Dr. John Lee, from Texas A&M, with over 40 years of experience in the field, at the end of last year for a one-year term in Corporation Finance.[17] We're looking forward to working with Dr. Lee and also to seeing what ideas come out of the concept release. Comments on the release are due February 19 and I encourage any of you with an interest in this area to share your views with us. I hope we will be able to move forward on this one later this year.

Management Guidance and Audit Standard No. 5. We completed issuing

management guidance last year after, I believe, 9 different concept, proposing, interpretive, adopting and postponing releases, and over a year of work. In addition, last summer the Commission approved the Public Company Accounting Oversight Board's Audit Standard 5, which replaced Audit Standard No. 2. Consistent with its ongoing efforts to reach out to the smaller public company community, the Commission most recently issued a small business guide for compliance with Section 404 last November.[18] In addition, in September the staffs of the Office of Chief Accountant and the Division of Corporation Finance updated the Frequently Asked Questions regarding Management's Report on Internal Control Over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports. These FAQs can be found on the SEC's website.[19] Non-accelerated filers are required to provide management assessment reports for the first time for fiscal years ending on or after December 15, 2007 and, in the case of calendar year companies, they are preparing those reports now. Under our current rules, the first auditor attestation reports for non-accelerated filers are due for fiscal years ending on or after December 15, 2008.

Up until last month, that was pretty much it for new developments in this area. However, on December 12, in testimony before the House Committee on Small Business, the Chairman announced that he would be recommending that the Commission authorize a further one-year delay in implementation of the Section 404(b) requirement — the auditor's attestation report — for non-accelerated filers to fiscal years ending on or after December 15, 2009. As he indicated, the staff plans to conduct a study of the costs and benefits of Section 404 compliance under the new management guidance issued in 2007, as well as new AS 5, which was approved by the Commission in July 2007 and is effective for audits of fiscal years ending on or after November 15, 2007. Also, the PCAOB staff is working on guidance in this area focused on auditing smaller companies. Preliminary PCAOB staff guidance was published in October, so an additional deferral of one year would allow additional time to promulgate this guidance and for auditors of non-accelerated filers to incorporate such guidance into their audits. So stay tuned for more developments in this area soon.

International Financial Reporting Standards (IFRS). International Financial Reporting Standards, or IFRS, is a topic that we spent a great deal of time on in the past year, and one in which you should see more from us in the coming year. It obviously relates to both of our principal initiatives for 2008 — financial reporting and international matters — so I will talk about it now in the context of both. In December the Commission adopted final rules under which foreign private issuers that prepare financial statements in their SEC filings using IFRS, as issued by the International Accounting Standards Board (IASB), will not be required to include a U.S. GAAP reconciliation.[20] This was an incredibly important step toward our long term goal of having a single set of high quality, globally accepted accounting standards. The new rules apply to financial statements for financial years ending after November 15, 2007 and interim periods within those years.

I want to draw your attention to one issue raised by the timing of the new rule with respect to eliminating the reconciliation requirement. The rule is

effective March 4, 2008, and until the rule is effective companies are subject to the existing rules regarding the inclusion of U.S. GAAP information. Some foreign private issuers with a fiscal year ending after November 15, 2007 may wish to file their annual report on Form 20-F prior to March 4, 2008 using financial statements prepared in accordance with IFRS as issued by the IASB and exclude the U.S. GAAP reconciliation. If you or your clients are in this situation, I encourage you to contact the Division of Corporation Finance's Office of Chief Accountant to discuss your facts and circumstances. Of course, any accommodation or waiver request must be made in writing.

Outstanding still in this area is the Commission's concept release, issued in August, which explores the possible use of IFRS by U.S. issuers.[21] This topic remains before the Commission, and it really is one that you all should be paying attention to, if you aren't already. This is significant for U.S. companies and their advisors, as well as for U.S. investors, and is a project that appears to have some momentum.

The concept release seeks information about the extent and nature of the public's interest in allowing U.S. issuers to prepare financial statements in accordance with IFRS as issued by the IASB for purposes of complying with the rules and regulations of the Commission, rather than preparing financial statements in accordance with U.S. GAAP, as is currently the standard. The comment period closed November 13, 2007 and members of the staff have been hard at work reviewing the comments submitted.

In an effort to obtain additional feedback from stakeholders, the Commission held two roundtables on IFRS in December 2007.[22] The first roundtable focused on the "big picture" question of whether U.S. issuers should be permitted to report their financial statements using IFRS rather than U.S. GAAP, while the second roundtable focused on the practical issues surrounding the possible future use of IFRS by U.S. issuers — that is, the mechanics of making the transition successful.

Repeating a few of my remarks from London, I would like to mention some of the interesting and thoughtful comments and points raised at those roundtables. Looking back, it appears there were three issues that generated near universal agreement among participants:

- First, our goal should be a single set of high-quality, globally accepted accounting standards. Panelists believed that uniform global standards would provide significant benefits to all stakeholders in the global capital markets, including U.S. investors.

- Second, the rest of the world is already heading in this direction and their endpoint is IFRS — not U.S. GAAP. There was little consideration given to the idea that U.S. GAAP could become the uniform global standard. This is an "inconvenient truth" for many in the U.S.

- Third, the possible future use of IFRS by U.S. issuers would require a multifaceted transition process and, as such, requires a comprehensive

plan to make the transition to IFRS reporting successful.

Of course, with any important policy decision there is going to be disagreement and we received quite diverse opinions from participants on a number of topics. Participants discussed the options for proceeding on the matters discussed in the concept release by proposing rules, the feasibility of two GAAPs coexisting in the U.S. capital markets, the problems with jurisdictional adaptations of IFRS, the impact of the concept release on the convergence process between U.S. GAAP and IFRS, and concerns with respect to the IASB governance structure. Participants also discussed the costs and benefits of allowing the use of IFRS in the U.S., why issuers would or would not switch to using IFRS, the mechanics of the transition for U.S. issuers, transition timing, investor education, auditor education, the regulatory, contractual, and legal implications of a transition to IFRS, the impact on private companies, and even the CPA exam.

One of the more debated topics was how to proceed from the concept release. Participants expressed a wide range of views and a number of overlapping options emerged:

- Have the Commission lay out a so-called "road map" of steps forward.
- Allow the voluntary use of IFRS for an indeterminate period. Under this option, we would allow some or all U.S. issuers to use either IFRS or U. S. GAAP for an indefinite period of time.
- Set a fixed date in the future for the mandatory use of IFRS. Under this option, we would select a date in the future and require that all issuers switch to using IFRS at that time. This was the approach followed in Europe.
- A "wait and see" approach on further rulemaking by the SEC, allowing convergence, investor understanding and the infrastructure for IFRS to further develop over the next few years.
- Various combinations of the above.

As I mentioned, we currently are focused on working through all of the very helpful input received on the concept release, both from commenters on the release and from panelists at the roundtables. This is obviously an important matter for U.S. investors and U.S. public companies and a significant issue for us this year.

International Rulemaking

As I noted initially this morning, the other leading theme for us this year in Corporation Finance is international matters, which I discussed at some length last week in London. I've already gone through IFRS, and I'll now just touch on some of the remaining international topics. If you are interested, my companion remarks from London on our website contain significantly

more detail on these topics.

Deregistration. In terms of our progress in 2007, on March 21 of last year the Commission approved new final rules that significantly changed the requirements regarding when and how foreign private issuers can exit the Exchange Act reporting system.[23] Unlike the older rules that required a foreign private issuer to have fewer than 300 U.S. holders before it could deregister, new Exchange Act Rule 12h-6 permits a qualifying foreign private issuer to deregister a class of equity securities if the U.S. average daily trading volume of the subject class of securities has been no greater than five percent of the average daily trading volume of that class of securities on a worldwide basis for a recent 12-month period. We met our goal of getting the new rule effective prior to June 30, 2007, to enable calendar year filers who desired to withdraw from U.S. registration prior to first being subject to filing SOX Section 404 reports in Form 20-Fs due on June 30 to do so. As anticipated, there was a small rush of filings immediately after effectiveness, and since then we have continued to see issuers use the new rule, but not in unexpected numbers.

As of year end, 100 foreign private issuers had filed Form 15Fs (not including 25 that had already deregistered under the older exit rules but filed Form 15Fs to gain the benefits of new Rule 12h-6). This corresponds to just under 9% of all foreign registrants, with the largest group (53 or 53%) coming from the European Union. As I've noted in other forums, some of our thinking here is that if you know you can leave when you want to, then it's more attractive to register or stay registered with us. I might also note as an aside, that during all of 2007, more than 75 new foreign private issuers registered securities with us.

Upcoming International Initiatives. After dealing with two of the more visible issues facing foreign companies — IFRS and deregistration — this coming year I anticipate that we will be turning to several less high profile, but nonetheless important, matters relating to foreign private issuers. I expect that these foreign issuer reporting enhancements may take a variety of forms and relate to a variety of rules — as we move forward, we may recommend providing relief and easing requirements for foreign issuers in some areas, while establishing new requirements in others, to achieve a fair and balanced regulatory approach to foreign issuers.

One area that I think we should consider revisions in is the Exchange Act Section 12(g) "entrance rules" for foreign private issuers, particularly in light of the new deregistration rules, or "exit rules" if you will. This area was raised in comments on the deregistration rulemaking, and is one that we've been thinking about for some time on our own as well. Our current exemption and exemption process under Rule 12g3-2(b) dates back 40 years and is ripe for revisiting.

A second area involves the use of automatic shelf registrations by foreign companies that are well-known seasoned issuers (WKSIs). Here, the current rules regarding the age of financial statements may limit their ability to use

automatic shelf registrations. Even though this issue is mitigated for some by our recent rule change eliminating reconciliation for issuers using IFRS as issued by the IASB, it will remain for those foreign private WKSIs that do not report in IFRS or U.S. GAAP. I believe that this particular area could be addressed by us in a way that is beneficial to foreign private issuers and investors.

Another, and related, area where change may be warranted, is the annual report filing deadline for foreign issuers. In this regard, the Commission has sought comment on advancing the six-month Form 20-F filing deadline several times since the late 1970s, most recently in connection with the IFRS proposing release. Though I cannot predict what may be proposed here, much less adopted, I will note that when the accelerated filing deadlines for U.S. issuers were implemented a few years ago, they were phased in gradually — I would think that a similarly measured approach could be appropriate here.

The basic application of the foreign private issuer definition itself is also on our radar for 2008. Whether a foreign company comes within or falls outside the foreign private issuer definition is a continuous determination that has extremely important regulatory consequences, such as compliance with Section 16, the proxy rules, Form 8-K reports and full U.S. GAAP financial statements. While the definition itself seems to be working, we think it may be appropriate to provide a definitive process with specific measurement dates that companies can look to for certainty as to their status.

The cross-border tender offer rules are another area in which the staff may recommend revisions in the near future. In fact, revisions to these rules are currently the number one rulemaking priority in our Office of Mergers and Acquisitions. With eight years of experience using the current rules, I believe that most will agree that the rules have worked well in balancing the need to promote the inclusion of U.S. security holders in cross-border transactions against the need to provide the protections of the federal securities laws to those holders. Despite the success of these rules however, the staff is considering revisions to address areas that may not be working as well as expected and areas where relief could be expanded. For example, it may be appropriate to make revisions with respect to the way U.S. ownership of a subject company's securities is calculated.

Mutual Recognition. With that, I'd like to touch just briefly on a final area on the international front, and one in which I anticipate the staff will be spending a significant amount of time in 2008 — mutual recognition. This is an area that crosses across Divisions and Offices at the Commission, and in which there has been a lot of discussion. Under the mutual recognition arrangements being discussed, foreign brokers and exchanges from selected jurisdictions would be allowed to operate in the U.S. without registration under certain circumstances. The mutual recognition model is premised in large part on a determination that a foreign regulatory regime provides comparable protections and results to those afforded to U.S. investors under our securities laws. I won't repeat all that I said in London last week, but I do want to reiterate the importance of thinking not just about issues relating to

the foreign brokers and exchanges themselves, but also issues relating to the foreign companies whose securities would be tradable through a mutual recognition system.

This focus on foreign companies is appropriate because, under a mutual recognition model, foreign exchanges and brokers could become, to a large extent, significant conduits for foreign issuer securities entering the U.S. markets and reaching U.S. investors. If I could try an analogy, it would be as if the federal government regulated the companies that imported cars into the United States and the dealerships that sold those cars, but did not assure that those cars being sold to U.S. drivers met appropriate standards for emissions and passenger safety. A good regulator should look at the products that are offered and sold through an import arrangement. In this case, the product of course is corporate securities. Issuer disclosure is obviously a hallmark of the U.S. regulatory regime and, in assessing comparability, a foreign jurisdiction's issuer standards with respect to financial and non-financial disclosure and corporate governance should be carefully considered. As I noted in London last week, this is all very preliminary, and it is unclear what direction the Commission ultimately may go, but I think it is important that we start thinking along these lines in developing any recommendations for the Commission to consider concerning a mutual recognition arrangement.

So that's it on our two big initiatives for 2008 — financial reporting and foreign initiatives. Let me now go back to three areas where we were very active in 2007 and review what we did and what additional work lies ahead in 2008.

Executive Compensation

As you probably know, in the fall of 2006 the Commission adopted new and expanded disclosure requirements relating to executive compensation and related person disclosure. This timing meant that the 2007 proxy season provided us with our first opportunity to see the new disclosures in companies' proxy statements. In an effort to both evaluate compliance with the revised rules and provide guidance on how companies could improve their first-time disclosures in this area, the Division undertook a review of the proxy statements of 350 companies last spring. These reviews are in many cases winding down, with many of them completed. Following our normal procedures, comment and response letter packages are beginning to be posted in EDGAR this month, not less than 45 days after completing the reviews.

After sending out the first round of comments, we put together our observations on companies' first efforts to comply with the new rules in a report published last October.[24] Overall, we thought companies generally made a good faith effort to comply with the new rules, and we applaud all those companies that worked with us to get the new and expanded disclosures out to investors. As I discussed at some length in a speech in San Francisco on the same day that the report was issued — "Where's the Analysis?"[25] — there definitely were some areas for improvement in

companies' second year under the new rules. The two main themes in our comments are manner of presentation and analysis. I'll give you just a couple highlights now, and refer you to the report and my San Francisco remarks for more detail.

With regard to manner of presentation, I urge companies and their counsel to focus on the idea that disclosure can be clear and understandable yet not meaningful or responsive to our disclosure requirements, and vice versa — it can be responsive in content, but not clear and understandable. Though manner of presentation does not refer only to plain English, plain English is a key part of all of this as well.

With regard to analysis, this was a frequent shortcoming. We saw a real lack of disclosure in the CD&A of the "how and why" of compensation decisions. This section is much like the MD&A with which you all have become so familiar and, as the Commission noted at adoption "is intended to put into perspective for investors the numbers and narrative that follow it."

From what I've heard back from company advisors over the past few months, the report and other materials on our website, including various interpretations we posted several times last year, have been helpful resources for companies in beginning to work with their disclosures for this proxy season, and I am very optimistic about second-year disclosures. As to our plans for this year, it's still too early to comment on that front.

Small Business Capital Raising and Private Offering Reform

First, as many of you know, last summer the Commission published a package of six proposals addressing small business capital raising and private offering reform. In November and December the Commission voted to adopt final rules on five of these proposals. This has been a very important project for us in the Division, and one to which we devoted a great deal of thought and resources in an effort to really get it right. In putting together the original recommendations to the Commission, we looked at the Advisory Committee on Smaller Public Companies recommendations, considered other helpful public input, and then came up with proposals that we thought were practical, and that accomplished what we could accomplish in the near term. We also took very seriously the comment process on each of these proposals and reflected the input we received in the final products. With one proposal still pending, this project continues as a focus for us, but I am happy to report that with five final rules behind us, it is substantially complete.

With regard to the five that we have completed, I'll mention those only briefly:

- In *Smaller Reporting Company Regulatory Relief and Simplification*,[26] the Commission expanded eligibility for our scaled disclosure and reporting requirements for smaller companies by making the scaled requirements available to all companies with up to $75 million in public float (which now are referred to as "smaller reporting companies"), and

also simplified the disclosure and reporting requirements for smaller companies.

- In *Revisions to the Eligibility Requirements for Primary Securities Offerings on Forms S-3 and F-3*,[27] the Commission revised the eligibility requirements of those forms to allow companies that do not meet the requirements of the forms for $75 million in public float to nevertheless register primary offerings of their securities, subject to a restriction on the amount of securities those companies may sell pursuant to the expanded eligibility standard in any one-year period. As I noted in my August remarks, it is our hope that the amendments provide eligible smaller public companies with access to the greater flexibility and efficiency in accessing capital afforded by Form S-3 and Form F-3, thus hopefully addressing some of the pressure on the PIPEs market.

- In *Exemption of Compensatory Employee Stock Options from Registration under Section 12(g) of the Securities Exchange Act of 1934*,[28] the Commission adopted two new exemptions from Section 12 (g), including an exemption, subject to several conditions, from registration for private non-reporting companies issuing options to employees, directors, and others provided for under Rule 701.

- In *Revisions to Rule 144 and Rule 145 to Shorten Holding Period for Affiliates and Non-Affiliates*,[29] the Commission shortened the holding period for the free resale of restricted securities by non-affiliates from two years to six months for reporting companies and to 12 months for non-reporting companies. Although the Commission did not reintroduce tolling for hedging activities, as was proposed, we will of course continue to monitor and revisit the issue if necessary. The amendments also raise the Form 144 filing thresholds and eliminate the presumptive underwriter provision in Rule 145, except with respect to transactions involving shell companies.

- And finally, in *Electronic Filing and Simplification of Form D*, the Commission mandated the electronic filing of the information required by Form D, revised and updated the Form D information requirements, and simplified and restructured Form D. This one isn't published yet, but you should be seeing it shortly, both on our website and in the Federal Register.

Still outstanding is *Revisions of Limited Offering Exemptions in Regulation D*,[30] in which the Commission proposed a new exemption from the Securities Act registration provisions for offers and sales of securities to "large accredited investors," with respect to which the issuer could engage in limited advertising. The proposals also would address the standards for qualifying as "accredited" investors under Regulation D, shorten the timing required by the integration safe harbor in Regulation D, and apply uniform disqualification provisions to all offerings seeking to rely on Regulation D. In addition, the release provides guidance regarding integration of concurrent public and private offerings. This one remains on our short list and I hope

that we will have final recommendations to the Commission soon.

And finally, as I have been hinting at for some time, we also continue to think about how our rules apply to so-called "voluntary filers" and whether further rulemaking or guidance in this area might be advisable. Still no promises on this one, but I'm hopeful that you will see something from us in the coming year.

A related topic that I will leave you with, which I think fits here even though it isn't part of the small business capital raising and private offering reform rulemaking, concerns "private investment public equity" offerings, or PIPEs offerings. And as I mentioned earlier, it is our hope that the Form S-3/Form F-3 rulemaking will take some pressure off this market.

This is a topic that I really thought was winding down when I spoke about it last August in my report on the Division's activities, but a recent court decision has reinvigorated the discussion on the topic, both inside and outside the SEC. In a recent case, *SEC v. John F. Mangan, Jr. and Hugh L. McColl, III*,[31] the Commission charged a PIPE investor with, among other things, violating Section 5 by using shares that the investor purchased from the issuer in the PIPE transaction and then re-sold pursuant to a resale registration statement to cover short positions it created prior to the filing and effectiveness of that resale registration statement. The North Carolina district court judge in *Mangan*, in a bench ruling without opinion, dismissed the Section 5 charge brought by the Commission. More recently, the Southern District of New York dismissed a similar Section 5 claim in *SEC v. Edwin Buchanan Lyon, IV*.

Although I cannot comment directly on the cases, I will take this opportunity to restate the Division's position concerning short sales and Section 5 generally. With respect to short sales, the time of the sale is when the seller of the securities establishes its short position. The staff has made a similar point as far back as at least the early 70s and nothing has changed on our end. So, applying this to a PIPEs offering, if the investor takes the shares it is selling off the resale registration statement to settle the short (or to return shares to the lender when borrowed shares were used to settle the short sale), that violates section 5 because the short sale was completed before the registration statement for those shares was effective.

As you can imagine, we are watching closely the developments in this area and assessing what, if any, response may be appropriate — obviously our priority here is to make sure that investors remain protected.

Proxy Matters

Proxy matters were another big area for us in 2007, and it looks like they will continue to be an important topic for us in 2008 as well. As I'll discuss in a moment, we took some really important steps last year with e-proxy and electronic shareholder forums in embracing technology and, hopefully, increasing shareholders' and companies ability to communicate with each

other effectively. We also spent some significant time thinking about and discussing how our federal proxy rules interact with shareholders' state law rights and whether we need to take steps to better align these two. Of course, shareholder director nominations were a big part of this thought and discussion.

E-Proxy. First, with regard to e-proxy, last year we saw the voluntary model go into effect as of July 1. This was followed, on January 1, 2008 with the second stage of the rulemaking, the revised model, becoming effective for large accelerated filers, other than registered investment companies. The revised model will go into effect for all other soliciting parties — issuers that are not large accelerated filers, registered investment companies, and soliciting shareholders — on January 1, 2009. This revised model, when fully implemented, will require that proxy materials be available on the Internet for the shareholders of all public companies (and that those companies and other soliciting persons follow the e-proxy rules for all proxy solicitations not related to a business combination transaction). Of course, shareholders will still be able to opt out and continue to receive their proxy materials in paper form.

Although this rulemaking is complete, we'll continue to monitor how the revised model is working so that we can make any changes necessary next year to smooth its use. In terms of what we've seen so far, we've heard from some that companies are still waiting to decide whether to use the voluntary model themselves this year. Although we've heard that the companies that have used e-proxy have seen significant savings, we've also heard that the retail vote goes down under e-proxy, so that may be one of the reasons that companies are being a bit cautious about using the model. On this point I'll just say that we're paying attention and this type of information is really helpful to us. So keep sharing your experiences with us — good and bad.

Shareholder Director Nominations. The other big rulemaking project in the proxy area in 2007 concerned shareholder director nominations. The Commission grappled with the question of shareholders' ability to have their director nominees included in company proxy materials. Unlike in 2003, when the Commission last issued rule proposals in this area, in this instance the question arose in the context of Rule 14a-8 — the shareholder proposals rule. Here the question was whether Exchange Act Rule 14a-8(i)(8), the "election exclusion," enables shareholders to have included in company proxy materials proposals that would establish procedures for shareholder director nominations. The purpose of the election exclusion is to ensure that investors receive adequate disclosure and an opportunity to make informed voting decisions in election contests, as stated by the Commission at the time the election exclusion was proposed in 1976.[33]

Accordingly, the agency has determined shareholder proposals that may result in a contested election — including those which establish a corporate procedure to list shareholder-nominated director candidates in the company's proxy materials — fall within the election exclusion. However, in September 2006, in *American Federation of State, County & Municipal Employees,*

Employees Pension Plan v. American International Group, Inc.[34] the U.S. Court of Appeals for the Second Circuit declined to defer to the agency's longstanding position and held that AIG could not rely on Rule 14a 8(i)(8) to exclude AFSCME's proposal. The Second Circuit interpreted the Commission's statement in 1976 as limiting the election exclusion "to shareholder proposals used to oppose solicitations dealing with an identified board seat in an upcoming election and reject[ing] the somewhat broader interpretation that the election exclusion applies to shareholder proposals that would institute procedures making such election contests more likely." This decision created significant uncertainty in the 2006-2007 proxy season regarding what proposals were properly excludable under the election exclusion.

In an effort to address the issue, in May of last year the Commission held three roundtables on the proxy process, focusing on the relationship between the federal proxy rules and state corporation law, proxy voting mechanics, and the evolution of both binding and non-binding shareholder proposals within the framework of the federal proxy rules. After considering what we had heard at the roundtables, as well as from public commenters, the Commission published for comment two alternative rule proposals. The first of these proposals would have amended Rule 14a-8 to enable shareholders to include shareholder nomination bylaw proposals in the company proxy materials under specified circumstances (e.g., where the shareholder held more than 5% of the company's shares and provided extensive disclosure concerning its background and relationship with the company). The proposal also included proposed revisions to the proxy rules to promote greater online interaction among shareholders.

In a second proposal the Commission discussed the agency's longstanding interpretation of the election exclusion and proposed an amendment to the language of Rule 14a-8(i)(8) codifying that interpretation (thus clarifying that a company may exclude from their proxy materials proposals that would result in an immediate election contest or would set up a process for shareholders to conduct an election contest in the future by requiring the company to include shareholders' director nominees in the company's proxy materials for subsequent meetings). We received over 34,000 comments in total on the two releases. So, as I probably don't need to say, this is an area that people feel strongly about in both directions.

After considering the numerous and helpful comments, on November 28, the Commission voted to adopt as a final rule the second proposal, codifying the agency's longstanding interpretation of the election exclusion.[35] The amendment is effective as of January 10. As was discussed at the open meeting, the Commission felt it necessary to act in advance of this year's proxy season to address the uncertainty created by the Second Circuit's decision. In this regard, we've already seen a few no-action requests concerning shareholder proposals to set up procedures for shareholder director nominations — from Bear Stearns, JP Morgan Chase, Verizon (which has since been withdrawn), and Croghan Bancshares. We will be responding to those in the coming month or so in accordance with our normal processes. Chairman Cox also made clear at the Open Meeting in November, however, that he would like us to continue to consider the broader question of

shareholder director nominations — so we are gearing up for further work in this area in 2008.

At the same meeting the Commission voted to adopt amendments to the proxy rules to facilitate the use of electronic shareholder proposals.[36] These rules were proposed in the first release, on which the Commission did not otherwise act. As was proposed, the amendments provide an exemption for solicitations on an electronic shareholder forum, and clarify that persons communicating on the forum will be liable for their own statements (in other words, a sponsoring company or shareholder would not be liable for statements made by others on the forum). These rules will be effective in mid-February.

Other Priorities and Projects

We also have quite a few Division priorities and projects for 2008 that, though they don't fit into a larger theme, like international reform or proxy matters, are quite important to the Division. For example, last month the Commission proposed amendments to Form S-11, the registration statement used by real estate entities to register offerings under the Securities Act of 1933.[37] The proposed amendments would permit an entity that has filed at least one annual report and that is current in its reporting obligations under the Securities Exchange Act of 1934 to incorporate by reference into Form S-11 information from its previously filed Exchange Act reports and documents. These proposed amendments mirror the amendments to Forms S-1 and F-1 that were adopted by the Commission during Securities Offering Reform, and have been on our short list of issues to address since then.

In addition, the project to update the guidance on the Corporation Finance website, and to update our website generally, is continuing to progress. I view our website as an important tool in carrying through with the transparency I mentioned earlier, so look for further developments this year, particularly with respect to continuing to update and organize the staff's interpretations so they are easily accessible and understandable.

Conclusion

So, as you can see, we were pretty busy in the Division of Corporation Finance in 2007, and I don't think that will be changing in 2008. I hope that I have provided some insight into what we've done and some of the promised transparency with respect to our plans for 2008. Again, thank you all for joining the Institute this year and for your kind attention this morning.

Endnotes

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[2] "Corporation Finance in 2007 — An Interim Report," John W. White, Director, Division of Corporation Finance, U.S. Securities and Exchange Commission, August 14, 2007, available at http://www.sec.gov/news/speech/2007/spch081407jww.htm.

[3] "Corporation Finance in 2008 — International Initiatives," John W. White, Director, Division of Corporation Finance, U.S. Securities and Exchange Commission, January 14, 2008, available at http://www.sec.gov/news/speech/2008/spch011408jww.htm.

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[6] See SEC Press Release 2007-213, "SEC Announces New Unit to Lead Global Move to Interactive Data," October 9, 2007, available at http://www.sec.gov/news/press/2007/2007-213.htm.

[7] See SEC Press Release 2007-191, "Market Cap of 'Interactive Data' Filers Tops $2 Trillion," September 20, 2007, available at http://www.sec.gov/news/press/2007/2007-191.htm.

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[11] See SEC Press Release 2007-123, "SEC Establishes Advisory Committee to Make U.S. Financial Reporting System More User-Friendly for Investors," June 27, 2007, available at http://www.sec.gov/news/press/2007/2007-123.htm.

[12] "Advisory Committee on Improvements to Financial Reporting — Draft

Decision Memo," January 11, 2008, available at http://www.sec.gov/about/offices/oca/acifr/acifr-ddm-011108.pdf.

[13] See Staff Accounting Bulletin 108, available at http://www.sec.gov/interps/account/sab108.htm.

[14] See Current Report on Form 8-K Frequently Asked Questions, Question 1, November 23, 2004, available at http://www.sec.gov/divisions/corpfin/form8kfaq.htm.

[15] SEC Release No. 34-42728, "Use of Electronic Media," April 28, 2000, available at http://www.sec.gov/rules/interp/34-42728.htm. See also SEC Release No. 33-7233, "Use of Electronic Media for Delivery Purposes," October 6, 1995, available at http://www.sec.gov/rules/interp/33-7233.txt.

[16] SEC Release No. 33-8870, "Concept Release on Possible Revisions to the Disclosure Requirements Relating to Oil and Gas Reserves," December 12, 2007, available at http://www.sec.gov/rules/concept/2007/33-8870.pdf.

[17] See SEC Press Release 2007-211, "SEC Division of Corporation Finance Appoints Academic Engineering Fellow," October 3, 2007, available at http://www.sec.gov/news/press/2007/2007-211.htm.

[18] "Sarbanes-Oxley Section 404 — A Guide for Small Business," available at http://www.sec.gov/info/smallbus/404guide.shtml.

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[23] SEC Release No. 34-55540, "Termination of a Foreign Private Issuer's

Registration of a Class of Securities under Section 12(g) and Duty to File Reports under Section 13(a) or 15(d) of the Securities Exchange Act of 1934," March 27, 2007, available at http://www.sec.gov/rules/final/2007/34-55540.pdf.

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[30] SEC Release No. 33-8828, "Revisions of Limited Offering Exemptions in Regulation D," August 3, 2007, available at http://www.sec.gov/rules/proposed/2007/33-8828.pdf.

[31] *SEC v. John F. Mangan, Jr., et al.*, 3:06CV531 (W.D.N.C. October 24, 2007).

[32] *SEC v. Edwin Buchanan Lyon, IV, et al.*, 06 Civ. 14338 (S.D.N.Y. January 2, 2008).

[33] "[T]he principal purpose of [Rule 14a 8(i)(8)] is to make clear, with respect to corporate elections, that Rule 14a 8 is not the proper means for conducting campaigns or effecting reforms in elections of that nature, since other proxy rules, including [Rule 14a 12], are applicable thereto." SEC Release No. 34-12598, "Proposed Amendments to Rule 14a-8 under the Securities Exchange Act of 1934 Relating to Proposals by Security Holders," July 7, 1976.

[34] *American Federation of State, County & Municipal Employees, Employees*

Pension Plan v. American International Group, Inc., 462 F.3d 121 (2d Cir. 2006).

[35] SEC Release No. 34-56914, "Shareholder Proposals Relating to the Election of Directors," December 6, 2007, available at http://www.sec.gov/rules/final/2007/34-56914.pdf.

[36] SEC Release No. 34-57172, "Electronic Shareholder Forums," January 18, 2007, available at http://www.sec.gov/rules/final/2008/34-57172.pdf.

[37] SEC Release No. 33-8871, "Revisions to Form S-11 to Permit Historical Incorporation by Reference," December 14, 2007, available at http://www.sec.gov/rules/proposed/2007/33-8871.pdf.

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